ASSOCIATION OF ACA CONSULTING ACTUARIES

UK 2007 *Pension trends survey report…2*

Sharp rise in defined benefit scheme costs and closures foreshadows widespread move to lower-cost pensions

Employers have felt the heat of pension liabilities

pension trends survey: changes in scheme provision, contributions, defined benefit scheme deficits and recovery plans

The Association of Consulting Actuaries (ACA) latest 2007 *ACA Pension trends survey* was conducted earlier this year. Over 330 schemes, with assets exceeding £127 billion and over 2.1 million members, responded to a wide range of topical pension questions. The first report focused on employers' views on current pension policies, the *2006 Pensions Bill* and responses to ideas posed by the Pensions White Paper on personal accounts. That report was published in June 2007 and is available from the ACA (see www.aca.org.uk – research page or see contact details on back page).

This second report confirms that there has been a further wave of defined benefit scheme closures over the last two years since our last *Pension trends* survey in 2005. **This year's survey found that 81% of defined benefit schemes run by respondents are closed to new entrants, up from 68% two years ago. The number of such schemes closed to future accrual of pension has increased to 14% of schemes.** Mirroring evidence reported elsewhere, the survey also found an increase in the closures of occupational defined contribution schemes, where trust based arrangements are being displaced by contract-based plans, notably GPPs.

The survey also found a pattern of mounting pension costs for those employers running defined benefit arrangements and the members of such schemes. Over the last five years, the average employer contribution to such schemes has nearly doubled from 11.5% of earnings to 22.6%. Member contributions too have increased, on average, by over to 40% from 4.3% of earnings to, on average, 6.1% now. Whilst there has been an increase in average employer contributions paid into defined contribution schemes over the same period, probably reflecting the larger employers now offering such schemes, these contributions fall well short of the levels that are likely to deliver anything near an equivalent pension to the defined benefit arrangements often previously in place. The concern remains – indeed it grows – that a high proportion of today's employees, particularly younger ones, will be seriously under-pensioned as mortality trends chip away at the likely long-term return from annuities. Additionally for some, due to the timing of their retirement, they will potentially suffer the impact of the volatility in investment returns associated with defined contribution arrangements.

Whilst the survey found over eight out of ten defined benefit pension schemes were in deficit at their last funding valuation, it also found that **employers have in many cases made special additional contributions to close the funding gap and responded to the Pension Regulator's encouragement to generally reduce recovery periods.**

With defined benefit final salary schemes increasingly proving too costly and risky for employers and defined contribution schemes too volatile in terms of what they may deliver, **the case for offering a 'third way' whereby both employers and employees can take advantage of the opportunities to provide cost-effective and more certain pensions through new risk sharing arrangements is underscored by the results of the survey.**

the key findings

defined benefit closures continue

81% of defined benefit schemes are closed to new entrants, of which 14% closed to future accruals. This is a marked increase in closures on the position 2 years ago.

pension contributions double over last five years into defined benefit schemes

average employee (6% of earnings) and employer (23%) contributions into defined benefit schemes have increased by between 40% and close to 100%, respectively.

longer-term worries over levels of pensions from defined contribution

defined contribution schemes are generally attracting combined employee (4%) and employer (6%) contributions of around 10% - close to one-third of the levels into defined benefit schemes - raising concerns over the level of pensions that will be delivered as more retirees become reliant on this type of scheme.

defined benefit deficits being addressed

scheme deficits are generally being addressed by increased regular and special contributions, and recovery periods are being reduced. Seven out of ten schemes expect to remove their deficit within 10 years.

scheme design: decline of final salary defined benefit pension schemes continues unabated

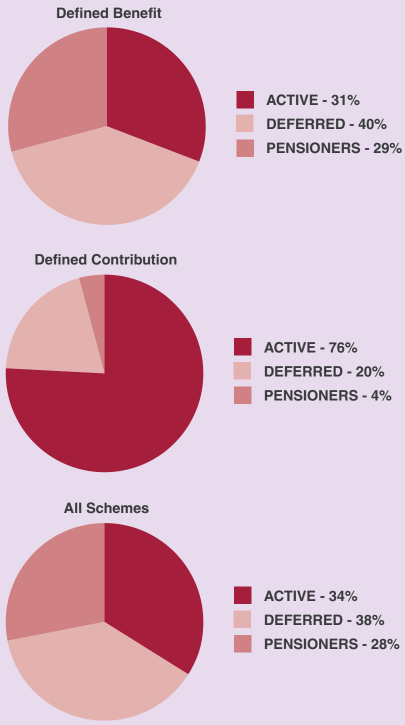
This year's *2007 Pension trends* survey attracted 336 employers responding to the questionnaire. The combined assets of these schemes were £127 billion, with over 2.1 million members. Figure 1 summarises the spread of pension arrangements these respondents run reported by size of employers. Whereas firms employing up to 250 employees are in the main dominated by defined contribution arrangements, 12% still run both defined benefit (usually closed) and defined contribution. In contrast, only 5% of firms with over 1000 employees only offer defined contribution (up from 1% in 2005), with 61% running both defined benefit and defined contribution.

A third of the larger firms still only offer a defined benefit scheme, down by about 10% on 2 years ago. Amongst the mid-sized firms, employing over 250 employees and up to one thousand, the switch away from defined benefit has been more rapid, with close to a quarter moving away from just offering a defined benefit plan in the last 2 years.

Figure 1: Size of firms responding to survey

Employees:	0-250	251-999	1000+
Defined benefit scheme only	2%	21%	34%
Defined benefit + defined contribution	12%	59%	61%
Defined contribution only	86%	20%	5%
Total sample of firms	17%	21%	62%

Figure 2: What is the distribution of membership of schemes?



Under a third of defined benefit scheme members are active members, underscoring the maturity of such schemes, whereas 76% of defined contribution members are active members, indicating the more recent establishment of such arrangements. The number of deferred pensioners – where employees have moved on to another employment or out of the labour market – is increasing, most markedly amongst defined contribution schemes over the last 2 years (see Figure 2).

The reasons why employers provide pension arrangements are still firmly welfare oriented. As with 2 years ago, an analysis of these answers by size of firm produced no marked variation in responses. This year, however, more employers said their pension scheme helped them to compete in the labour market for skilled staff, indicating that the continuation of a 'good scheme', whether defined benefit or defined contribution, is of increasing importance in recruitment and retention. This suggests the message about the importance of a good pension may be reaching more ears than has been the case for some years. The consequence for public policy is that it is likely to be more effective if it encourages workplace pensions by appealing to employers' desires to be seen to be a 'good employer' (see Figure 3).

Figure 3: Why do firms provide employees with pension arrangements (in ranked order)?

	All Schemes
We consider it is our responsibility as a good employer to make adequate arrangements for our employees retirement	1 (1)
The scheme helps us to build our image as a caring employer, motivating and encouraging loyalty from employees	2= (2)
The scheme helps us to compete in the labour market for skilled staff	2= (3)
The scheme enables us to retire employees on reasonable pensions in an orderly way to suit our business	4 (4)
The scheme has been in existence for many years and could not easily be discontinued	5 (5)
We were required to introduce a scheme under the Stakeholder rules	6 (6)

(Figures in brackets are 2005 ACA Pension trends survey rankings)

Eight out of ten defined benefit pension schemes are now closed to new entrants – up from seven out of ten 2 years ago, with 14% now also closed to future accruals. The impact of this transformation of UK private sector pension provision over a relatively short period of time has yet to be fully appreciated.

The real concern must be the extent to which those now outside of defined benefit arrangements will be 'under pensioned' compared to their predecessors and, just as worrying, the degree to which they will be subject to much greater volatility in the size of any defined contribution pension they may now be earning for the same levels of contributions, due to inevitable variations in investment returns from year to year that are associated with such schemes.

Whilst the survey reveals that more firms have established group personal pensions and stakeholder defined contribution schemes over the last 2 years, there is mounting evidence that some employers are now closing their trust based defined contribution schemes (see Figure 4), probably on the grounds of the additional regulatory and administrative burdens involved compared to contract based schemes. This trend may reflect a further type of levelling-down in provision, over and above the switch away from defined benefit, which may particularly affect the employees of small to medium sized firms, where the trend is most apparent. As our first survey report on pension reform issues identified, there is strong evidence to suggest that a levelling-down in workplace pension arrangements will take place alongside the introduction of low-cost personal accounts in 2012 as employers rationalise their pension arrangements and address the costs of auto-enrolment (see report 1 of ACA *2007 Pension trends* survey at www.aca.org.uk – research page).

Levelling-down of pensions already underway

Figure 5: Changes in pension arrangements over last few years

	In last year	In last 5 years
Closed defined benefit scheme to new entrants	5%	41%
Closed defined benefit scheme to future accruals	5%	8%
Introduced defined contribution scheme to some or all employees	8%	22%
Converted existing defined benefit to mixed DB/DC scheme	2%	-
Set up a career average scheme	1%	3%
Reduced percentage of employees covered by firm's scheme	-	4%
Placed one or more schemes in wind-up	4%	4%
Established a flexible benefits package with wider benefits option	1%	6%
Introduced access to group benefits largely paid for by employees	1%	3%
Contracted some or all of members back into State Second Pension	8%	6%

Figure 4: What type of pension arrangement do firms offer and what is the total value of scheme assets?

Type of pension scheme	Percentage of firms with such schemes	% Closed to new entrants	% Closed to new entrants and future accruals/new contributions	Total asset values (£bn)
Defined benefit scheme	68% (71%)	67% (58%)	14% (10%)	£116.4
Defined contribution	38% (39%)	12% (5%)	4% (2%)	£5.2
Mixed DB / DC	9% (14%)	-	-	£3.8
Group Personal Pension	21% (16%)	5%	-	NK
Stakeholder	24% (22%)	-	-	NK
Industry-wide	2% (2%)	50%	-	£2.1
All Schemes	-	-	-	£127.5

(NK: the majority of respondents did not disclose or were unaware of total assets held.
Figures in brackets are 2005 ACA Pension trends survey results)

Whilst defined benefit schemes still dominate in terms of the assets held by schemes, 41% of employers running such arrangements report that they have closed off this type of scheme to new entrants in the last 5 years and 5% this year (see Figure 5).

Whilst a few employers have set up mixed or career average schemes over the period, the most common change has been to move more employees into defined contribution schemes, which, at present, are the simplest alternative for employers which are 'risk free'. The incidence of closures of defined benefit schemes to future accruals has also increased on 2 years ago, as has the practice of contracting some or all members back into the State Second Pension scheme.

Whilst the vast majority (92%) of defined benefit schemes remain contracted out of the State scheme, only 14% of defined contribution schemes responding to the survey are contracted out.

pension contributions: big increases mask long-term decreases

Average combined employer and employee contributions into defined benefit schemes are now 29% of earnings, not far short of double the level of 5 years ago. This huge 80% increase over the period has been split between employers and employees (see Figure 6).

Whilst employees have on average contributed an extra 1.8% of earnings to pensions, employers have on average added 11% (an increase of 97% over the period). These increases, almost without exception, will have been made not to enhance benefits, but to fund benefits at a time when deficits have been widespread amongst schemes due to lower investment returns, higher benefit costs through legislation and faster-than-expected improvements in longevity.

Over a six-year period, the survey has found an improvement in overall contributions, albeit much smaller, into defined contribution arrangements. With combined contributions now averaging 10% into both occupational defined contribution and group personal pensions, we said two years ago that there was some evidence that as larger firms switched their pensions to defined contribution, they were doing so at higher levels of contributions than hitherto made by firms with longer-standing defined contribution schemes. Two years on, there is no great evidence that this trend has continued, although, looking to the longer-term, employers offering defined contribution schemes do seem to expect both employer and employee contributions to rise. This is in contrast to those schemes offering defined benefit arrangements, who expect longer-term combined contributions to fall by around 5% (but still leaving contributions at twice the average level into defined contribution).

Disappointingly, combined contributions into stakeholder plans have stuck around the 8% level – far short of that needed to provide a good pension in retirement – with in many cases such plans attracting well below these levels of contributions, notably the 28% reported in this survey that attract no employer contribution whatsoever.

Figure 6: Average of contributions paid into pension schemes (as a percentage of total earnings)

Average employer contributions into:							
	2002	2003	2004	2005	2006	2007	Long-term expected
Defined benefit scheme	11.5%	13.1%	15.1%	16.5%	21.0%	22.6%	17.0%
Defined contribution	5.1%	5.2%	5.8%	5.9%	6.0%	6.2%	7.4%
Group Personal Pension	5.6%	5.6%	5.8%	6.1%	5.8%	6.0%	7.2%
Stakeholder (see note)	5.0%	5.2%	4.3%	4.5%	4.0%	4.1%	6.0%

Average employee contributions into:							
	2002	2003	2004	2005	2006	2007	Long-term expected
Defined benefit scheme	4.3%	4.5%	4.9%	5.5%	5.8%	6.1%	6.5%
Defined contribution	3.4%	3.5%	4.0%	4.1%	4.1%	4.1%	5.0%
Group Personal Pension	3.6%	3.8%	3.6%	3.8%	4.0%	3.9%	4.3%
Stakeholder	3.3%	3.5%	3.7%	3.8%	4.1%	4.1%	5.3%

Average combined employer and employee contributions into:							
	2002	2003	2004	2005	2006	2007	Long-term expected
Defined benefit scheme	15.8%	17.6%	20.0%	22.0%	26.8%	28.7%	23.5%
Defined contribution	8.5%	8.7%	9.8%	10.0%	10.1%	10.3%	12.4%
Group Personal Pension	9.2%	9.4%	9.4%	9.9%	9.8%	9.9%	11.5%
Stakeholder (see note)	8.3%	8.7%	8.0%	8.3%	8.1%	8.2%	11.3%

(Source: ACA 2003, 2005 and 2007 Pension Trends Surveys
Note: figures exclude nil employer contributions made into 28% of Stakeholder schemes)

The range in contribution levels is quite different between types of schemes. Predictably, the range of both employer and employee contributions into defined benefit schemes starts at a higher level and finishes at a very much higher level than into defined contribution. Since 2005, the shift towards higher employer contributions into defined benefit schemes has been particularly marked, with half of employers recording average contributions of 20% of earnings or more, compared to under a third two years ago (see Figure 7).

Some 42% of employees in membership of defined benefit schemes are making contributions of 6% or more into their scheme, compared to just 10% of employees in membership of defined contribution schemes (and far fewer in membership of group personal pension or stakeholders).

The range of employer contributions into defined contribution schemes has not changed much from 2005. Indeed, over half of all these schemes attract employer contributions of 6% of earnings or less – slightly more than two years ago, again suggesting there is some levelling-down of contributions into these types of arrangements.

Figure 7: Current range of pension contributions

Employer contributions as % of earnings	Defined Benefit	Defined Contribution	GPP	Stakeholder
0%	-	-	-	28% (30%)
Up to 3%	- (1%)	2% (4%)	12% (4%)	11% (11%)
Over 3 – 6%	1% (1%)	53% (48%)	42% (41%)	43% (28%)
Over 6 – 9%	4% (7%)	23% (26%)	35% (44%)	11% (21%)
Over 9 – 12%	14% (11%)	19% (18%)	7% (11%)	7% (7%)
Over 12 – 15%	14% (30%)	3% (4%)	4% (-)	- (3%)
Over 15 – 20% (18%)	18% (c20%)	-	-	-
Over 20 - 25% (Over 18%)	15% (30%)	-	-	-
Over 25%	34%			

Employee contributions as % of earnings	Defined Benefit	Defined Contribution	GPP	Stakeholder
0%	6% (5%)	- (5%)	-	- (5%)
Up to 2%	- (2%)	6% (4%)	7% (5%)	9% (5%)
Over 2 – 4%	10% (15 %)	51% (42%)	50% (53%)	42% (61%)
Over 4 – 6%	42% (36%)	33% (39%)	38% (37%)	46% (26%)
Over 6 – 8%	32% (38%)	10% (6%)	5% (5%)	3% (3%)
Over 8%	10% (4%)	- (4%)	-	-

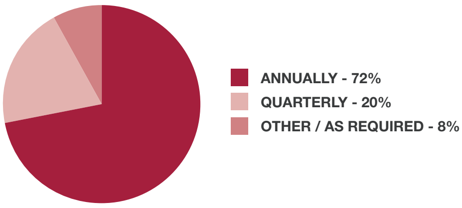
(Figures in brackets are 2005 ACA Pension trends survey results)

scheme deficits: gradually improving position, but at a price

The extent of deficits in defined benefit schemes has been much reported since 2000 and is the topic of everyday reports in the national press as deficits are reported to increase or decrease as equity markets and interest rates and AA corporate bond yields move up or down.

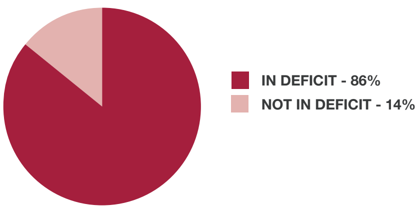
Our 2007 survey examined the FRS 17 scheme deficits reported by respondents based on their most recent actuarial valuation (prior to February 2007). Whilst the vast majority of schemes now seek informal updates of their individual scheme's position (see Figure 8), and improvements in the financial position of the scheme since the last formal valuation may be leading onto changes in the investment mix of the scheme, employers must continue to fund in the light of the recovery plan based on the last triennial valuation.

Figure 8: How frequently do you undertake informal updates of the actuarial valuation?



The survey found that based on their last actuarial valuations, 86% of defined benefit schemes were in deficit, with an average funding level of 87% (on an ongoing funding basis as a percentage of liabilities). This is a modest improvement on the figures reported in 2005 (See Figure 9).

Figure 9: Number of defined benefit schemes advised by their actuaries that their scheme is in deficit when considering it as an ongoing entity (as reported to survey in February 2007)



Provided equity market improvements are sustained and the upward trend in long-term real interest rates persists the expectation must be that deficits will show sizeable reductions in the period ahead as new triennial valuations are conducted.

The improvement in FRS 17 deficit positions is reflected in the bands of deficits reported to the survey. Only 10% of schemes said their funding level was below 75% as compared to 18% two years ago. And two-thirds said their funding level was better than 85% compared to just over a half two years ago (See Figure 10).

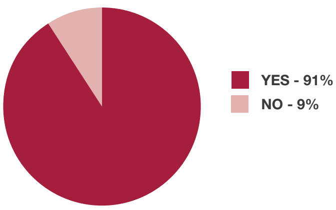
Figure 10: Bands of ongoing funding level (as reported to survey in February 2007)

Funding level	Percentage of schemes
+ 100%	14% (11%)
+95 – 100%	9% (6%)
+85 – 95%	44% (40%)
+75% - 85%	23% (25%)
Below 75%	10% (18%)
Average ongoing funding level	87% (85%)

(Figures in brackets are 2005 ACA Pension trends survey results)

91% of firms say their Scheme Actuary has recommended increases in contributions as a result of the deficits found at the last actuarial valuation (see Figure 11).

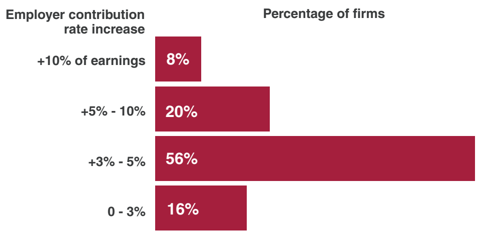
Figure 11: If in deficit, have the scheme actuaries recommended an increase in contributions?



As reported earlier, employers have responded to scheme deficits by increasing contribution rates. Whilst 16% have only increased contributions by up to 3% of earnings, 28% have increased contributions by upwards of 5% of earnings (see Figure 12). These sizeable increases in contributions have taxed many employers and in no small part have highlighted the risks inherent in providing final salary based defined benefit schemes, the result of which has been, first, the closure to new entrants and, second, the developing trend of closure of schemes to future accrual of pension for existing members.

Employers have acted to reduce scheme deficits.

Figure 12: Change in employer defined benefit contribution rates



Around a third of employers have made fixed monthly or annual additional contributions and another third have paid significant lump sums to reduce their scheme deficits (see Figure 13).

Figure 13: Have additional employer contributions been made expressed as fixed monthly amounts or significant lump sums?

As a result of the blend of higher level of contributions and additional payments, employers have generally managed to reduce the recovery periods over which they propose to eliminate their scheme deficits. Whereas two years ago 44% of employers expected to remove their deficit over a period exceeding 10 years, by February this year this group has reduced to 29% of employers (see Figure 14).

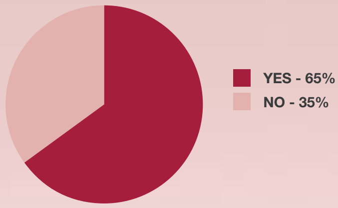
Figure 14: Period over which firms say scheme deficits are expected to be removed?

0 – 5 years	15% (23%)
6 – 10 years	56% (33%)
11 – 15 years	20% (39%)
+15 years	9% (5%)

(Figures in brackets are 2005 ACA Pension trends survey results)

It is noteworthy that defined benefit employer contributions have been increased not solely to eliminate past service deficits. Changes in longevity and forward expectations of investment returns have meant that two-thirds of employers have increased contributions in order to meet future service benefits (See Figure 15). Again, the need to do this has highlighted the risks of providing schemes of this type.

Figure 15: Have defined benefit employer contributions been increased to meet future service benefits?



Members of defined benefit schemes are also contributing more to safeguard their past and future service benefits. 45% of employers report increases (or future increases) in member contributions, with the majority falling in a range of up to an additional 2% of earnings (See Figure 16).

Figure 16: Number of schemes reporting increase (or future increase) in defined benefit member contribution rates

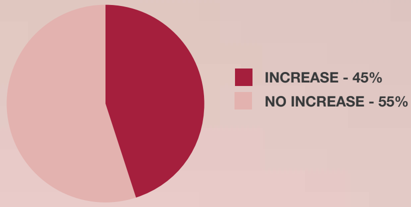
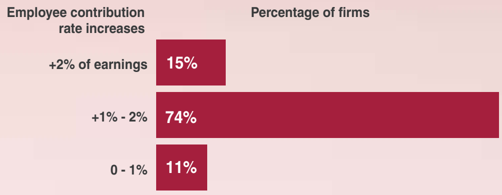


Figure 17: Change in member contribution rates



conclusions: government must back good schemes too

The results published in this second report of the *2007 ACA Pension trends* survey are both encouraging and discouraging. Yes, there is evidence that employers and members have worked together to address past service scheme deficits in defined benefit schemes. In particular, employers have raised their game by both increasing regular contributions and special contributions to address the deficit issue in a timely way. Although, recovery periods still in many cases look long, changes in market conditions, if they persist, could ease this situation markedly over the next few years. Employees too have played their part by in many cases contributing significantly more for their final salary based benefits.

But a price has been paid for the deficit ‘crisis’ that emerged in 2000 and the consequence has been two-fold.

First, employers have in the main resolved that ‘never again’ will pension commitments threaten the long-term financial viability of their business. As a result, rapid de-risking has taken place in the shape of defined benefit scheme closures, initially to new entrants and now increasingly to future accruals. In the absence of any better alternative, new defined contribution schemes have generally replaced these schemes. Our 2007 survey has found only marginal evidence that larger employers are contributing to these schemes at levels likely to lead to pensions anywhere near comparable to those emerging under former defined benefit schemes.

The second consequence has been further Government pension reforms. These reforms promise to deliver an extension of private pensions – at a basic level – to those employees that presently want to save, but who have (despite the introduction of stakeholder pensions a few years ago) no viable vehicle through their present employer. We have warned that care will be needed in planning these new personal accounts so they do not undermine better provision that presently exists. This view was echoed by the views of respondents detailed in our first report on this survey, published in June (see www.aca.org.uk – research page).

As this report is written, we await the outcome of the report to the Government by external reviewers on the deregulation of private pensions. This second branch of Government reforms offers the prospect of changes that will help existing good occupational schemes to continue and – we hope – encourage the development of new workplace schemes that are designed to be less volatile than defined contribution.

The survey results underscore the need for new pension schemes that are better than the minimum. The rapid closure of defined benefit schemes to both new entrants and increasingly to future accruals for existing employees means that there are now only around 2 million members of open private sector defined benefit schemes, compared to over 5 million just ten years ago, and compared to around 5 million defined benefit public sector members. Despite the establishment of more defined contribution schemes in recent years, the Government’s own figures indicate that fewer and fewer employees are now covered by any workplace scheme (source: ONS, Pension Trends, 5 December 2006). Fresh thinking is needed to promote new pension schemes that fill the gap.

Our Association has advocated simple legal reforms that would allow more employers to establish risk sharing pension schemes. Members of new shared risk schemes would benefit from pensions that are less volatile than defined contribution arrangements, whilst employers, through such schemes, would be able to control costs in a way they cannot with final salary schemes.

shared risk schemes: designed to cope with future change

New *shared risk* schemes could work to fill the gap being left as final salary schemes close to new entrants and future accrual. It is vital these new schemes are encouraged by legislative reforms in the 2007/08 session of Parliament, in advance of the introduction of personal accounts, which may otherwise cause a general 'levelling down' of provision (see report 1 in this 2007 series at www.aca.org.uk – research page).

By their design, these *shared risk* schemes will enable employers to control costs into the future even if there are down swings in investment returns and continued improvements in mortality. For members, the advantages will flow from a more stable benefit platform than money purchase provides and regular indexation of benefits supported by the new prudent funding regime.

Those few existing occupational pension schemes which have been designed to share risks between employer and employee have had their risk sharing ability restricted as they have been classified as defined benefit schemes, with all the regulatory burdens this type of scheme now involves.

The new category of *shared risk* schemes proposed would allow creative benefit designs and would sit between the existing categories of defined benefit and defined contribution schemes.

For those employers who are still providing final salary or other defined benefit schemes and who wish to review their existing arrangements, a new *shared risk* scheme for future service benefits would enable the employer to continue to take some of the risks rather than leaving them all to be taken by the employees, if instead a defined contribution scheme was to be put in place.

For those employers who have already replaced their final salary scheme with a defined contribution scheme, the possibility of a new *shared risk* scheme would allow the employer to take some of the risks presently placed on employees rather than leaving them completely exposed to money purchase volatility. Recent surveys have found many employers are concerned about the adequacy of defined contribution schemes they have set up.

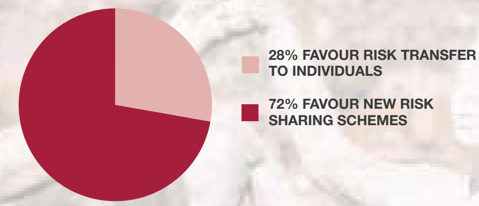
Pensions under a *shared risk* scheme would be based on the member's average pensionable earnings during the period of scheme membership rather than the member's pensionable earnings at retirement (as is the case in a final salary scheme). The pension earned for each year of service would be re-valued from that year to the date of retirement and increased when in payment in line with price inflation (up to the 2.5% yearly cap in current legislation).

Each year's pension would be a defined benefit, but future annual revaluations to that pension to the date of retirement and future annual increases when in payment would be targeted, supported by a funding reserve based on prudent actuarial assumptions under the new scheme specific funding regime. As each year passes, the year's revaluation and pension increase would then automatically become a defined benefit, subject to the funding position of the scheme not showing a past service funding shortfall at that time.

New *shared risk* schemes would include those types of cash balance plan, where the retirement benefit is defined as a capital sum at normal pension age and then converted into pension at that time, which met the relevant criteria.
Shared risk scheme members should be protected by the Pension Protection Fund, but with lower levies on employers reflecting the lower risks associated with such schemes.

As we showed in report 1 of this 2007 survey, some 72% of employers responding to the survey said they supported the promotion of new risk sharing schemes that combined better cost control for employers and a more stable benefit platform for employees. Amongst firms with 250 employees or more, support for such an initiative increased to three-quarters of those sampled.

Figure 18: Support for risk transfer to individuals as against promotion of new risk sharing schemes



the key attractions of a *shared risk* scheme for employers and employees

For employers and employees: an employer could expect to provide a pension similar to a defined benefit pension based on a member's average pensionable earnings revalued to retirement and increased in payment in line with price inflation (subject to the statutory 2$\frac{1}{2}$% annual cap) but for a stable contribution rate into the future.

For employers: unlike an existing defined benefit scheme, however, there would be under the rules of *shared risk* schemes the flexibility for the employer to:

- not grant a year's revaluation or pension increase if a past service funding shortfall emerged (but in practice, over the long term, past service funding surpluses, emerging because of the new scheme specific funding requirements, would be expected to finance reinstatements)
- reduce the rate of future service pension accrual
- increase normal pension age for active and deferred members subject to sufficient evidence of increasing life expectancy and to certain protections for scheme members
- wind up the scheme without providing full future revaluation and full future increases to pensions in payment (although the expectation would be that, over the long term, sufficient past service funding surplus would have been built up to secure many of the potential future revaluations and pension increases).

In practice, many employers may mitigate the above effects by making modest additional contributions.

For employees: importantly, because of the mechanisms for the sharing of risks between the employer and scheme members and by way of the modest pooling of risks amongst scheme members, the benefits provided by a *shared risk* scheme should form a much more stable platform for income in retirement than would be achieved by the same contributions paid to a defined contribution arrangement.

For further details about shared risk schemes, go to www.aca.org.uk and consult the 'publications' page - 29 March 2007.

This is the second report in a series on the results of the ACA 2007 Pension trends survey. The third report covering investment issues and including the full statistical results of the survey will be published in the Autumn.

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